

REPORT OF EXAMINATION
OF THE
HEALTH NET LIFE INSURANCE COMPANY

AS OF
DECEMBER 31, 2006

Participating State
and Zone:

California

Filed October 23, 2007

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Los Angeles, California
September 7, 2007

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Kent Michie
Secretary, Zone IV-Western
Commissioner of Insurance
Department of Insurance, State of Utah
Salt Lake City, Utah

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

HEALTH NET LIFE INSURANCE COMPANY

(hereinafter also referred to as the Company) at the primary location of its books and records, 21281 Burbank Blvd., B3, Woodland Hills, California 91367.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2006. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and

an evaluation of the assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; business in force by states; mortality and loss experience; accounts and records; and sales and advertising.

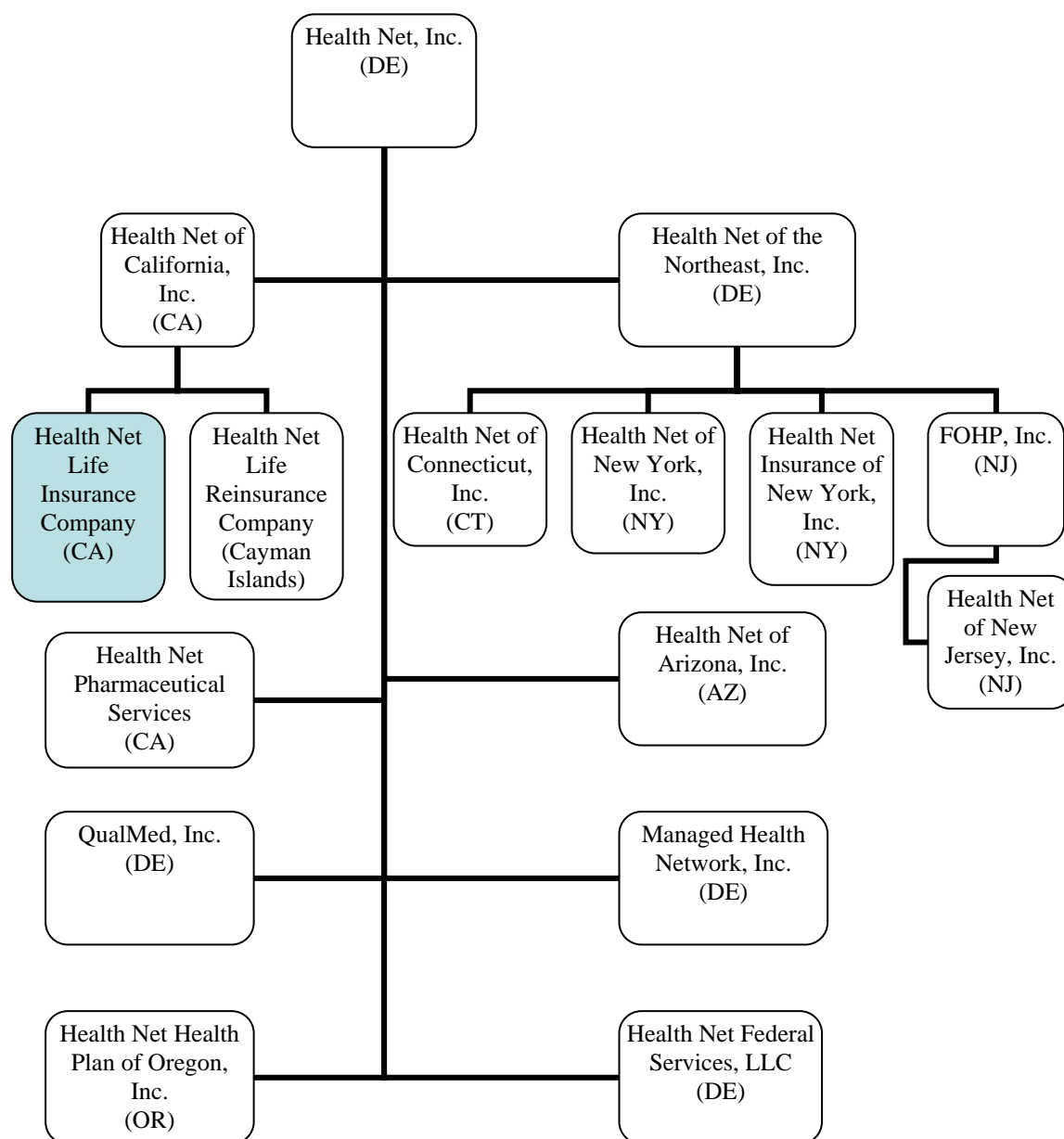
COMPANY HISTORY

On December 28, 2005, the Company consummated the statutory mergers of MHN Reinsurance Company of Arizona and Health Net Insurance of Connecticut, Inc. into the Company. The assets, liabilities, and capital and surplus of the Company have been restated to reflect the merger as if it had occurred on January 1, 2004. No adjustments were made directly to the surplus of the Company as a result of the merger.

As of December 31, 2005, Health Net of California (HNCA), Inc. the parent company, and Health Net, Inc., its ultimate parent company, had contributed \$27 million more than the original \$55 million commitment stipulated in the guarantee agreement to the Company to maintain a certain minimum level of capital and surplus. On May 31, 2007, HNCA contributed \$36 million in cash as capital contribution to the Company. For the years ended December 31, 2006, 2005 and 2004, the Company paid a cash dividend of \$35 million, \$19.5 million and \$15 million, respectively, to HNCA.

MANAGEMENT AND CONTROL

The Company is a wholly-owned subsidiary of Health Net of California, Inc., and is ultimately owned by Health Net, Inc., one of the nation's largest publicly traded managed health care companies. The following abridged organizational chart, which is limited to the Company's parent along with certain subsidiary insurance companies, depicts the Company's relationship within the holding company system:



Management of the Company is vested in a five-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2006 follows:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Mark El-Tawil Gilbert, Arizona	Vice Chairman of the Board Health Net Life Insurance Company
Stephan D. Lynch Woodland Hills, California	Chairman of the Board Health Net Life Insurance Company
Mark J. Morgan Newbury Park, California	Senior Vice President Health Net Life Insurance Company
Franklin Tom Los Angeles, California	Secretary Health Net Life Insurance Company
James E. Woys Fair Oaks, California	President Health Net Life Insurance Company

Principal Officers

<u>Name</u>	<u>Title</u>
James E. Woys Roupen Berberian	President and Chief Executive Officer Vice President, Chief Financial Officer and Treasurer
Franklin Tom Wisdom Lu	Secretary Vice President and Chief Investment Officer

Management Agreements

Administrative Services Agreements: Effective January 1, 2003, the Company entered into various administrative service agreements with Health Net, Inc. (HNI), Health Net of California, Inc. (HNCA), Health Net Health Plan of Oregon, Inc., Health Net of the Northeast, Inc., Health Net of Arizona, Inc., Managed Health Network, and Managed Health Network Services to receive and/or render certain administrative services, managerial support, consulting and other support services including executive, government relations, internal audit, legal, finance, human resources, marketing, medical management, government programs, actuarial and underwriting, membership accounting, purchasing, and IT administration services and support. According to these agreements, the Company is to reimburse or charge its affiliates for the actual fair and reasonable pro rata costs and expenses incurred or utilize cost factors to calculate and allocate costs. The Company paid \$111.3 million and \$59.5 million for 2006 and 2005, respectively, for services provided by affiliates and the Company received payment of \$1.5 million for services rendered to affiliates for both 2005 and 2006. These agreements were approved by the California Department of Insurance (CDI) on various dates in 2003.

Claims Administrative Services Agreement: Effective October 1, 2002, the Company entered into an agreement with Health Net Pharmaceutical Services (HNPS) to receive outpatient prescription benefit management services. The Company compensates HNPS twice monthly based on a cost allocation of the number of claims paid for all covered medications for the enrollees of the Company compared with the number of claims paid for all covered medications for the enrollees of the Company and its affiliates. The agreement was approved by the CDI on September 16, 2003.

Premium Administration Agreement: Effective January 1, 2003, the Company entered into a premium administration agreement with HNCA to jointly market a dual option product. The agreement uses risk adjustment allocations to mitigate the subsidy resulting from select risks of an individual employer group and helps ensure that the relationship between the aggregate premium payments of HNCA and the Company equitably correspond with the benefit costs for the enrollees of

the same employer group. For the year ended December 31, 2006, HNCA allocated premiums totaling \$7.6 million to the Company. The agreement was approved by the CDI on June 17, 2003.

Tax Allocation and Indemnification Agreement: The Company and its affiliates have an agreement with the ultimate parent HNI to file federal income taxes on a consolidated basis. The Company shall pay HNI an amount equal to a separate return tax liability. If the Company is entitled to a tax credit or incurs a net operating loss during a taxable period HNI will apply such credit to the Company. The Company is filing the agreement with the CDI for approval to comply with California Insurance Code (CIC) Section 1215.5(b)(4).

Holding Company Transactions

The Company entered into a Joint Enterprise Agreement effective March 31, 2005 and amended on May 26, 2005 with its affiliates, Health Net Insurance of New York, Inc. (HNINY) and Health Net Insurance of Connecticut, Inc. to form a joint enterprise for the purpose of applying to Center for Medicare and Medicaid Service (CMS) to become authorized for Prescription Drug Plans for the purpose of offering Medicare Part D Prescription Drug Benefits in certain CMS designated regions. Health Net Insurance of Connecticut, Inc. was merged into the Company on December 28, 2005. At year end of 2006, the Company recorded \$12.3 million payable to HNINY representing an allocation of CMS payments. However, the Company did not report the agreement in its Form B filing nor obtain prior approval from the CDI to comply with CIC Sections 1215.4 and 1215.5(b)(4). It is recommended that the Company file the agreement with the CDI for approval and report the agreement in its Form B filing.

TERRITORY AND PLAN OF OPERATION

The Company markets life insurance, preferred provider organization (PPO) health, point of service (POS) health, indemnity health, dental, vision, medicare supplement, behavioral health and life insurance products. The life insurance products include group term life, individual term life,

accidental death and dismemberment (AD&D), supplemental term life and dependent term life. Beginning in 2006, the Company offered a Medicare Part D Prescription Drug benefit product.

As of December 31, 2006, the Company was licensed to sell life and accident and health products in 48 states and the District of Columbia. The following is a listing of the states in which the Company is licensed:

Alabama	Illinois	Montana	Rhode Island
Alaska	Indiana	Nebraska	South Carolina
Arizona	Iowa	Nevada	South Dakota
Arkansas	Kansas	New Hampshire	Tennessee
California	Kentucky	New Jersey	Texas
Colorado	Louisiana	New Mexico	Utah
Connecticut	Maine	North Carolina	Vermont
Delaware	Maryland	North Dakota	Virginia
Florida	Massachusetts	Ohio	Washington
Georgia	Michigan	Oklahoma	West Virginia
Hawaii	Mississippi	Oregon	Wisconsin
Idaho	Missouri	Pennsylvania	Wyoming

On February 16, 2007, the Company became licensed in the State of Minnesota.

In 2006, the Company wrote \$1.28 billion in direct premiums. Of the direct premiums written, \$816 million (63.4%) was written in California, \$180 million (14%) was written in Arizona, and \$161 million (12.5%) was written in Oregon.

In 2007, the Company plans on marketing the Medicare Part D Prescription Drug Benefit product in every state except New York. Also, in 2007, the Company launched a Medicare Private Fee-for-Service product in six states.

REINSURANCE

Assumed

The Company has excess of loss reinsurance agreements with its affiliates: Health Net of New Jersey, Inc., Health Net of Arizona, Inc. and Health Net Health Plan of Oregon, Inc. The Company also has an affiliated quota share reinsurance agreement with Health Net of New Jersey, Inc. Under these reinsurance agreements, the Company assumes excess of loss coverage on various products in Arizona, Oregon and New Jersey, and assumes one hundred percent of the out of network Point of Service product business in New Jersey.

Ceded

Effective January 1, 2004, the Company entered into a 40% quota share reinsurance agreement (50% in 2005 and thereafter) with Health Net Life Reinsurance Company (HNLRC), an unauthorized affiliate, for the California based PPO health business. Effective January 1, 2006, the Medicare business from all regions was added to the treaty. HNLRC had trust deposits totaling \$83 million as of December 31, 2006, to back the ceded reserve credits taken by the Company.

The offset provision in the treaty with HNLRC was not acceptable as it contained the word “or otherwise”. In order to prevent an inadvertent incorporating of an offset right into a liquidation setting, the items, which may be offset, must be expressly stated and cannot include words such as “otherwise” or “etc”. It is recommended that the Company amend the offset provision in the treaty to comply with California Insurance Code Section 922.2.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2006

Reconciliation of Capital and Surplus
from December 31, 2003 through December 31, 2006

Statement of Financial Condition
as of December 31, 2006

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 255,329,078	\$	\$ 255,329,078	(1)
Cash and short-term investments	(11,256,297)		(11,256,297)	
Contract loans	5,337		5,337	
Receivables for securities	21,938		21,938	
Investment income due and accrued	2,360,524		2,360,524	
Premiums and considerations:				
Uncollected premiums and agents' balance in course of collection	21,246,891	2,823,471	18,423,420	(2)
Amounts recoverable from reinsurers	5,401,447		5,401,447	
Amounts receivable relating to uninsured plans	202,395		202,395	
Net deferred tax asset	4,623,345	60,915	4,562,430	
Receivable from parent, subsidiaries and affiliates	30,079,575	5	30,079,570	
Health care and other amounts receivable	119,742,231	24,461,089	95,281,142	(3)
Aggregate write-ins for other than invested assets	<u>949,565</u>	<u>949,565</u>		
Total assets	<u>\$ 428,706,029</u>	<u>\$ 28,295,045</u>	<u>\$ 400,410,984</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Aggregate reserve for life policies and contracts			\$ 607,131	(5)
Aggregate reserve for accident and health policies			14,397,361	(5)
Contract claims: Life			346,885	(5)
Accident and health			101,731,356	(4)
Premiums and annuity considerations received in advance			18,066,311	
Contract liabilities not included elsewhere:				
Provision for experience rating refunds			15,411,711	(5)
Commissions to agents due or accrued			3,941,454	
General expenses due or accrued			2,373,255	
Taxes, licenses and fees due or accrued			3,039,866	
Current federal income taxes			10,004,564	
Remittance and items not allocated			1,211,579	
Asset valuation reserve			496,001	
Payable to parent, subsidiaries and affiliates			17,915,481	
Aggregate write-ins for liabilities			<u>7,368,305</u>	
Total liabilities			196,911,260	
Common capital stock		\$ 2,500,000		
Gross paid-in and contributed surplus		151,469,172		
Unassigned funds (surplus)		<u>49,530,552</u>		
Surplus			<u>203,499,724</u>	
Total liabilities, capital and surplus			<u>\$ 400,410,984</u>	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2006

Statement of Income

Premiums and annuity considerations	\$ 816,480,176	
Net investment income	15,564,681	
Amortization of interest maintenance reserve (IMR)	(140,753)	
Commissions and expenses allowance on reinsurance ceded	67,729,507	
Aggregate write-ins for miscellaneous income	<u>4,181,222</u>	
Total		\$ 903,814,833
Death benefits	955,675	
Disability benefits and benefits under accident and health policies	606,499,572	
Interest and adjustments on contract	13,193	
Increase in aggregate reserves for life and accident and health contracts	(1,519,415)	
Commissions on premiums	52,901,755	
General insurance expenses	129,281,418	
Insurance taxes, licenses and fees, excluding federal income taxes	20,509,170	
Aggregate write-ins for deductions	<u>3,358</u>	
Total		<u>808,644,726</u>
Net gain from operations before federal income taxes		95,170,107
Federal income taxes incurred		33,457,264
Net realized capital losses		<u>(111)</u>
Net income		<u>\$ 61,712,732</u>

Capital and Surplus Account

Capital and surplus, December 31, 2005	\$ 191,551,738
Net income	\$ 61,712,732
Change in net deferred income tax	925,350
Change in non-admitted assets and related items	(15,602,487)
Change in assets valuation reserve	(93,711)
Surplus adjustment: Paid in	6,102
Dividends to stockholders	<u>(35,000,000)</u>
Net change in capital and surplus for the year	<u>11,947,986</u>
Capital and surplus, December 31, 2006	<u>\$ 203,499,724</u>

Reconciliation of Capital and Surplus
from December 31, 2003 through December 31, 2006

Capital and surplus, December 31, 2003,
per Examination

\$ 164,372,912

	Gain in Surplus	Loss in Surplus
	<u> </u>	<u> </u>
Net income	\$ 120,812,296	\$
Change in net deferred income tax	2,172,740	
Change in nonadmitted assets and related items		19,185,332
Change in asset valuation reserve		233,630
Change in surplus notes		205,000
Capital changes: Paid in	300,000	
Surplus adjustments: Paid in	6,102	
Dividends to stockholders		69,500,000
Aggregate write-ins: additional surplus from merger	<u>4,959,636</u>	
Total gains and losses in surplus	<u>\$ 128,250,774</u>	<u>\$ 89,123,962</u>

Increase in capital and surplus

39,126,812

Capital and surplus, December 31, 2006,
per Examination

\$ 203,499,724

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Company has a custodial agreement with Bank of New York Trust Company which has not been submitted to the California Department of Insurance (CDI) for approval as required by California Insurance Code Section 1104.9(d). It is recommended that the Company submit its custodial agreement to the CDI for approval.

(2) Uncollected Premiums and Agents' Balance in Course of Collection

The Company retroactively recorded 2005 risk accrual of certain plan with Center for Medicare and Medicaid Service (CMS) at \$3.6 million at year end of 2006. As of the examination report date, the Company has not received payment. It is recommended that the Company evaluate the collectibility of the amount and comply with Statement of Statutory Accounting Principles (SSAP) No. 6, paragraph 10.

(3) Health Care and Other Amounts Receivable

Included in the above captioned account were primarily Pharmaceutical Rebate Receivables and Medicare Receivables:

Pharmaceutical Rebate Receivables: The Company reported a \$40 million net pharmacy rebate receivable which includes both estimated and billed pharmacy rebate receivables. Pursuant to SSAP No. 84, paragraph 10, estimated pharmacy rebate receivable related solely to actual prescription filled during the 3 months immediately preceding the reporting date of December 31, 2006, and billed pharmacy rebate receivable represents receivables that have been invoiced or confirmed in writing but not collected as of the reporting date. Based on the review of the supporting documents, the amount reported was overstated by approximately \$3 million. Due to the immateriality of the

amount, no examination adjustment is being proposed. However, it is recommended that the Company disclose the method used to estimate the receivables per SSAP No. 84, paragraph 24. It is also recommended that the Company enhance its internal control in reconciling pharmacy claim data to ensure the accurate calculation of pharmacy rebate receivables.

Medicare Receivables: The Company reported a \$53.9 million Medicare receivable, net of reinsurance, from the CMS as of the examination date under Medicare Part D Prescription Drug Plan. This account was evaluated by a consulting actuary retained by the CDI and was determined to be reasonable. As of the examination report date, the Company has not received any payment. It is recommended that the Company evaluate the collectibility of amount receivable periodically pursuant to SSAP No. 84, paragraph 23.

(4) Contract Claims: Accident and Health

The Company's contract claim reserves for accident and health policies were evaluated by a consulting actuary retained by the CDI. Based upon the evaluation, the reserves contract claims were determined reasonable.

(5) Aggregate Reserve for Life Contracts
Aggregate Reserve for Accident and Health Contracts
Contract Claims: Life
Provisions for Experience Ratings Refunds

The Company's reserves for life, accident and health policies were evaluated by a consulting actuary retained by the CDI. Based upon the evaluation, the reserves were determined reasonable.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Holding Company Transactions (Page 6): It is recommended that the Company obtain approval for the Joint Enterprise Agreement made with its affiliates and report the agreement in Form B filing to comply with the California Insurance Code (CIC) Sections 1215.4 and 1215.5(b)(4).

Reinsurance – Ceded (Page 8): It is recommended that the Company amend the offset provision in the quota share treaty with Health Net Life Reinsurance Company.

Financial Statement Items – Bond (Page 13): It is recommended that the Company submit its custodial agreement to the California Department of Insurance (CDI) for approval in compliance with CIC Section 1104.9(d).

Financial Statement items – Uncollected Premiums and Agents' Balance in Course of Collection (Page 13): It is recommended that the Company evaluate the collectibility of the receivable from the government and comply with Statement of Statutory Accounting Principles (SSAP) No. 6, paragraph 10.

Financial Statement Items – Health Care and Other Amounts Receivable – Pharmaceutical rebate receivables (Page 13): It is recommended that the Company disclose the method used to estimate pharmaceutical rebate receivable pursuant to SSAP No.84, paragraph 24. It is also recommended that the Company enhance its internal control in reconciling pharmacy claim data to ensure the accurate calculation of pharmacy rebate receivables.

Financial Statement Items – Health Care and Other Amounts Receivable – Medicare receivables (Page 14): It is recommended that the Company evaluate the collectibility of amount receivable periodically pursuant to SSAP No. 84, paragraph 23.

Previous Report of Examination

Management Agreements – Tax Allocation and Indemnification Agreement (Page 6): It was recommended that the Company take appropriate actions and amend the agreement to reflect the correct names of all entities that are parties to the agreement. The Company made the name change filing. However, the Company is filing the agreement with the CDI for approval to comply with the CIC Section 1215.5(b)(4).

Corporate Records (Page 7): It was recommended that the Company take appropriate actions to comply with CIC Section 1201. The Company implemented this recommendation.

Reinsurance – Ceded (Page 9): It was recommended that the Company amend its reinsurance contracts to include the appropriate language as required by CIC Section 922.2(a)(2). It was also recommended that the Company amend the reinsurance contracts to reflect the correct entity name. The Company made the appropriate amendments.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

_____/S/_____
Irene Song, CFE
Examiner-In-Charge
Senior Insurance Examiner (Specialist)
Department of Insurance
State of California